

Internal Revenue Service

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

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Date:

December 03, 2020

LEGEND

X =

Y =

A =

B =

C =

D =

Trust1 =

Trust2 =

State =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Date8 =

N1 =

N2 =

N3 =

Dear :

This responds to a letter dated May 22, 2020, submitted on behalf of X by the authorized representatives of X, requesting a ruling under §1362(f) of the Internal Revenue Code ("Code").

FACTS

The information submitted states that X was formed under the laws of State on Date1 and elected to be an S corporation effective on Date2. At the time of X's formation, X was owned equally by A and B. On Date3, A formed Trust1 for the benefit of C. Also on Date3, A formed Trust2 for the benefit of D. On Date4, A transferred N1 shares of X each to Trust1 and Trust2. X represents that Trust1 and Trust2 have always met the requirements as a Qualified Subchapter S Trust (QSST), except that no QSST election had been filed on behalf of either Trust1 or Trust2 effective on Date4.

On Date5, Trust1 transferred its N1 shares to Y, a limited liability company formed by A under the laws of State on Date6 and classified as a partnership for federal income tax purposes, in exchange for a promissory note in the amount of \$N2. In addition, on Date5, Trust2 transferred its N1 shares of X to Y in exchange for a promissory note in the amount of \$N2. X represents that it had not been informed about these transfers of X stock to Y, and until recently it was unaware that its S corporation election would have terminated on Date5 as a result of the stock being transferred to an ineligible shareholder. On Date7, A (as manager of Y) and B (as president of X) entered in a redemption agreement whereby X agreed to redeem all of the shares of X held by Y

in exchange for a promissory note in the amount of \$N3. This redemption occurred on Date8.

X represents that X and X's shareholders have always filed tax returns consistent with X being an S corporation. In addition, X represents that Trust1 and Trust2 have always filed tax returns consistent with their treatment as QSSTs. X further represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and each person who was a shareholder of X at any time since Date4 agree to make any adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(d)(1) provides, in pertinent part, that a QSST whose beneficiary makes an election under § 1362(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of § 678(a)) of that portion of the QSST's S corporation stock to which the election under § 1361(d)(2) applies. Under § 1361(d)(2)(A), a beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), the election will be effective up to 15 days and two months before the date of the election.

Section 1361(d)(3) provides that for purposes of § 1361(d), the term "qualified subchapter S trust" means a trust (A) the terms of which require that – (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust; and (iv) upon termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the election by signing and filing with the

service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under § 1362(d)(2) is effective on or after the date of cessation.

Section 1362(f) provides, in pertinent part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken so that the corporation is a small business corporation; and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date4 resulting from the failure by C and D to properly and timely file QSST elections on behalf of Trust1 and Trust2, respectively. In addition, X's S corporation election would have terminated on Date5 as a result of X stock being transferred to an ineligible shareholder, if X's election has not previously terminated on Date4. We conclude that these terminating events were inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation on Date4 and thereafter, unless X's S corporation election otherwise terminated under § 1362(d) for reasons not stated in this letter.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied regarding X's eligibility to be an S corporation or the validity of its S corporation election. In addition, no opinion is expressed or implied as to whether Trust1 or Trust2 qualify as QSSTs.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to your authorized representatives.

Sincerely,

Richard T. Probst
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: